



NATIONAL
BANK OF
UKRAINE

Macroeconomic and Monetary Review

June 2016



Monetary Policy and Economic Analysis Department

Summary

- **In June, the Fed rate decision and the UK's EU membership referendum shaped the world financial and commodity markets.** The Fed decision to keep its rate unchanged supported emerging market currencies in early June, although depreciation pressures renewed after Brexit vote. **While external prices remained favorable for Ukrainian exporters in May, a steep decline in steel prices in June, as well as increased markets' volatility amid heightened post-referendum uncertainty, could, however, tighten the external environment for Ukrainian exports in the short-run.**
- **In May 2016, as expected, consumer inflation continued to slow down - to 7.5% y-o-y compared with 9.8% y-o-y in April.** Overall, consumer price developments were in line with the projected disinflation path published by the NBU in the Inflation Report (April 2016). Thus, the headline inflation target for the end of 2016 (12% +/-3 pp) remains within reach. The **slowdown of core inflation (to 8.8% y-o-y in May)** confirmed the fundamental nature of easing inflationary pressure. The NBU attributes the slowdown of core inflation to the strengthening of the hryvnia exchange rate and subdued consumer demand. Supply-side factors supported a further decline in raw food inflation. Meanwhile, the rise in world commodity prices caused an **acceleration of producer price inflation to 16.4% y-o-y.**
- **In May, IKSO growth continued moderating to 1.5% y-o-y** due to a higher base of comparison, subdued consumer demand, and a growth in industrial production slowing to almost zero. In particular, the decline in coal mining resumed due to lower purchases by heating power plants. Closely linked to industry performance, wholesale trade turnover and freight turnover slowed down. Meanwhile, agricultural production posted a marginal increase. The growth in construction activity slowed. However, growth accelerated in the residential segment, reflecting improved expectations of construction companies and a slight recovery of demand in the primary market.
- **Nominal average wage growth accelerated slightly - to 23.3 % y-o-y in May.** Amid easing inflationary pressure, this led to a **further sharp growth in real wages (up by 12.2% y-o-y)**. The end of the heating season caused a significant reduction in the quantity of households that received subsidies (down to 4 million). The total amount of subsidies accrued also substantially decreased. However, the announcement of the government's plan to further raise utility payments resulted in a sharp increase in the number of households that applied for subsidies in advance.
- In May, **the growth in State Budget revenues resumed (by 11.8% y-o-y) primarily due to tax revenues** (owing to improved economic performance in recent months and due payment of taxes paid on a quarterly basis). Increases in expenditures slowed down seasonally due to lower spending on subsidies to households. The State Budget deficit narrowed (to UAH 4.3 billion) while surplus of local budgets increased (to UAH 5.6 billion). As a result, **the consolidated budget showed a surplus** in May. This resulted in a decrease in its cumulative negative balance - to UAH 3.8 billion.
- As anticipated, **the current account remained in surplus in May (USD 403 million).** Despite favorable external conditions, merchandise exports decreased, to a notable extent due to lower maize exports to China. The decline in non-energy imports accelerated amid fading effects of deferred demand. Gas imports were record low for the last seven years. The financial account was virtually balanced in May. The public sector did not make any significant transactions and the private sector balance was close to zero as well. The overall balance of payments surplus (USD 374 million) contributed an **increase in international reserves up to USD 13.5 billion (or 3.5 months of future imports) as of 31 May 2016.**
- In May-June, the **FX supply remained considerable** due to favorable external conditions and a reduction in the energy sector's FX purchases. As a result, **the trend towards the hryvnia appreciation continued.** This allowed the NBU to continue relaxing its FX restrictions, including dividend repatriation. The volume of domestic currency deposits also continued recovering. However, despite a slight increase in the volume of domestic currency loans, the lending activity of banks remained weak. **Steady alleviation of inflationary pressure amid improved inflation expectations enabled the NBU to continue easing monetary policy. On 24 June 2016, the NBU reduced the key policy rate to 16.5%.**

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